



Early Journal Content on JSTOR, Free to Anyone in the World

This article is one of nearly 500,000 scholarly works digitized and made freely available to everyone in the world by JSTOR.

Known as the Early Journal Content, this set of works include research articles, news, letters, and other writings published in more than 200 of the oldest leading academic journals. The works date from the mid-seventeenth to the early twentieth centuries.

We encourage people to read and share the Early Journal Content openly and to tell others that this resource exists. People may post this content online or redistribute in any way for non-commercial purposes.

Read more about Early Journal Content at <http://about.jstor.org/participate-jstor/individuals/early-journal-content>.

JSTOR is a digital library of academic journals, books, and primary source objects. JSTOR helps people discover, use, and build upon a wide range of content through a powerful research and teaching platform, and preserves this content for future generations. JSTOR is part of ITHAKA, a not-for-profit organization that also includes Ithaka S+R and Portico. For more information about JSTOR, please contact support@jstor.org.

there was no showing that the presence of the gasoline either caused or contributed to the fire. "Nor is it necessary to show in order to maintain a defense upon a policy like the one in controversy, that the fire occurred by reason of the violation in such respect of the terms of the policy. The question is whether the condition of the policy has been violated." Citing *Turnbull v. Home Fire Ins. Co.*, 163 N. Y. 237. So also *Bastian v. British American, Etc. Co.*, 143 Cal. 287 (1904), the court saying "If it were incumbent on the insurer in each case to prove that the fire was caused by dynamite being on the premises, it would render the clause in most cases of no affect;" *Kensfick-Hammond Co. v. Fire Ins. Soc.*, 205 Mo. 294 (1907); *Boyer v. Fire Ins. Co.*, 124 Mich. 455 (*semble*).

It would seem, then, that the holdings of the courts in these cases turning on the military service clause that a causal relation between the service and death must be shown in order to warrant a denial of recovery of the full amount are out of harmony with the decisions in cases fairly analogous. If there were real occasion for construction, of course it would be proper to resolve the doubt against the company in favor of the insured. It is submitted that in these cases there has been no room for such construction, not even with the word 'engaged.' To require the insurer to show a causal connection between the service and death would be to open the door to inquiries which in many cases could not be satisfactorily answered and would impose a burden on the company which as said by the California court in the *Bastian Case*, *supra*, "would render the clause in most cases of no effect."

R. W. A.

STOCK DIVIDENDS AND THE FEDERAL INCOME TAX.—A question which has interested the legal profession and those of the public owning stock in prosperous corporations has recently been decided by the Federal Supreme Court. It was held, four justices dissenting, that stock dividends are not taxable as income. *Eisner v. Macomber*, — U. S. — (1920) 40 Sup. Ct. 189. The tax in question was assessed under the Federal Income Tax Law of 1916, which provided in Part I, § 2, (a):—"That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation * * *, which stock dividend shall be considered income, to the amount of its cash value." The court held this section invalid as contrary to Art. I, Sect. 2, Cl. 3, of the Constitution, which provides that all direct taxes shall be apportioned among the several states according to population, the court deciding that the word 'income' in the Sixteenth Amendment did not include stock dividends notwithstanding the construction Congress attempted to put upon the word.

Although four members of the court dissented, two of those four differed from the majority only on the construction of the word 'income' as used in the Sixteenth Amendment. The other two justices differed radically from the majority on the question of the nature of a stock dividend, taking the position that there was no difference between a dividend in cash and a dividend in

stock. There is considerable authority for this position. In the case of *Tax Commissioner v. Putnam*, 227 Mass. 522, a stock dividend was held to be taxable as income, the court stating at p. 535;—"It was the issuance to the stockholder of a new thing of value, transferable, transmissible, and salable separate and apart from that which before he had possessed." It is worth noting that this statement was by the highest court of the state which has given the name to the rule that stock dividends are capital and not income as between life tenant and remainder man. *Minot v. Paine*, 99 Mass. 101. See also 13 MICH. L. REV. 242; 18 MICH. L. REV. 69.

A recent appeal case from Australia also supports the theory of the dissenting justices. It was held in *Swan Brewery Co., Ltd., v. Rex*, [1914] A. C. 231, under a statute putting a tax on 'dividends,' that a transaction, whereby certain surplus was charged to capital account and new shares issued *pro rata* to stockholders, was a 'dividend' and taxable under the act. "There can be no doubt that the new shares were distributed and were not the same things as the old ones." *Id.* p. 235. In both this case and the *Putnam case*, *supra*, the courts make the comparison between a 'straight' stock dividend and an optional 'cash-for-stock' dividend on which Justice Brandeis places great stress in the instant case. The court says,—“Had the company distributed the (money) among the shareholders and had the shareholders repaid such sums to the company as the price of the * * * new shares, the duty on the (money) would clearly have been payable. Is not this virtually the effect of what was actually done? I think it is.” *Swan Brewery Co. case*, *supra*, p. 236. This argument is plausible but it must be borne in mind that there is the same difference between such an optional 'cash-for-stock' transaction and a straight stock dividend that there is between the latter and a cash dividend. Moreover, such 'cash-for-stock' dividends are anything but straightforward transactions and have a tendency to deceive the stockholders and to take advantage of their ignorance or need of ready money. Since the price at which the new stock is offered is necessarily less than the actual value, (otherwise the scheme would not be workable), such an arrangement is well calculated to squeeze out the small stockholders and puts a premium on 'inside' knowledge. If the increase in stock is bona-fide there is no reason why any such optional arrangement should be made.

There are many reasons for believing that a stock dividend is essentially different in kind from a cash dividend. "It is the characteristic feature of a stock dividend that the property of the corporation itself remains unchanged, but that each one of the shares of the increased capital stock represents a smaller fractional interest than before in the total amount of the corporate property. On the other hand it is the characteristic feature of a dividend declared and paid wholly from the net profits or undivided earnings that it does diminish the property of the corporation by exactly the amount of the dividend so paid out, while it leaves the fractional interest represented by each share of the capital stock exactly what it was before." *Gray v. Hemenway*, 212 Mass. 239, 241, citing *Gibbons v. Mahon*, 136 U. S. 549. "A stock dividend gives the stockholder merely the evidences of additions made by the corporation to its own capital. He can, it is true, still retain the old stock certificates

and sell the new ones, but by so doing he parts with so much of his interests in the capital of the corporation." *DeKoven v. Alsop*, 205 Ill. 309, 314. The court states the proposition forcibly in *Towne v. Eisner*, 245 U. S. 418, (holding stock dividends not taxable as income under the Law of 1913). The court says, at p. 426,—“* * * if certificates for \$1000 par were split up into ten certificates each, for \$100, we presume that no one would call the certificates income. What has happened is that the plaintiff's old certificates have been split up in effect and have diminished in value to the extent of the value of the new.”

A leading text-writer on this subject says that income “* * * is not synonymous with ‘increase.’ The value of corporate stock may be increased by good management, prospects of business, and the like, but such increase is not income. It may also be increased by the accumulation of a surplus fund. But so long as that surplus is retained by the corporation, either as a surplus or as increased stock, it can in no proper sense be called income. It may be income-producing, but it is not income.” BLACK, INCOME AND OTHER FEDERAL TAXES, [3rd. Ed] Sect. 100.

Another writer expresses his view of the subject in a novel manner. “No one had the temerity to use this expression about a stock dividend—*it is nothing at all* * * * just like receiving five ones for a five-dollar bill.” MONTGOMERY, INCOME TAX PROCEDURE, p. 188. He proceeds to explain, pp. 214, 215,—“It cannot be shown that the stockholder had a greater proportion of the company's net worth than before; it cannot be shown that the company distributed one dollar of its assets—the whole strength in the argument lies in the statement that he has a piece of paper which recites that he has become possessed of a certain specific part of the corporation's new capital stock, that it is now called capital on the books, whereas shortly before it was called surplus, and that said surplus account having once been divided it can never be divided again, so he is on notice that he will not get another dividend from the same surplus. * * * We are reduced to an examination of one argument, viz., that so long as the amount of the dividend was in surplus account it might be dissipated, and that it was more secure when called capital stock. * * * As a matter of fact the argument is so weak that it falls with its own weight. * * * There is no such thing as dissipation of surplus; if dissipation is going on it is of assets, and bad management in dissipating assets goes on regardless of whether there is a surplus account on the books or whether the assets being dissipated represent capital stock.”

If the majority of the court was correct in its conclusion on this point, and the authorities cited *supra* seem to support it, the court's construction of the word ‘income’ in the Sixteenth Amendment was certainly justified. The Sixteenth Amendment did not extend the power of taxation to new or excepted subjects, but merely removed the occasion for apportioning taxes on income among the states. *Peck & Co. v. Lowe*, 247 U. S. 165. There is nothing in the wording of the amendment which should cause the courts to abandon its own prior definitions of ‘income.’ “Whatever difficulty there may be about a precise and scientific definition of ‘income,’ it imports * * * some-

thing entirely distinct from principal or capital either as a subject of taxation or as a measure of the tax * * *." *Doyle v. Mitchell Bros. Co.*, 247 U. S. 179, 185.

Similar definitions of income were approved by the court long before the decision in *Pollock v. Farmers' Loan and Trust Co.*, 158 U. S. 601, which reversed the previous holdings that an income tax was an excise tax and so made necessary the adoption of the Sixteenth Amendment before the present Income Tax Law could be enacted. Under the Income Tax Law of 1867, the increased value of bonds over their cost price was held not to be income. *Gray v. Darlington*, 15 Wall. 63. A federal court, in construing the Income Tax Law of 1870, stated: "In the absence of any special provision of law to the contrary, income must be taken to mean money, and not the expectation of receiving it, or the right to receive it, at some future time." *U. S. v. Schillinger*, 14 Blatch. 71. It may perhaps be said that the court in the principal case showed little regard for the interpretation of the Sixteenth Amendment favored by the legislative branch of the government, but it can hardly be denied that the ultimate interpretation of the Constitution is for the judicial, and not the legislative department of government.

It was contended by the government in this case that since Congress could tax the increased assets as income to the corporation, therefore it should be considered as income to the stockholder. This is in effect to urge double taxation, not as an anomaly to be tolerated, but as a principle to be followed as of right. On the contrary the fact that Congress might conceivably tax this same increased value in a different way is one very good reason for not taxing it in this way.

R. L. C.